Rating: Buy
S&P 500: 1166

Petro-Canada
Looking for Long Life

Symbol	PCZ	*Ebitda Next Twelve Months ending 9/30/05 (US$mm)*	4,200
Rating	Buy	*North American Natural Gas/Ebitda (%)*	22
Price (US$/sh)	53.10	*Natural Gas and Oil Production/Ebitda (%)*	85
Pricing Date	11/5/04	*Adjusted Reserves/Production NTM*	7.6
Shares (mm)	269	*EV/Ebitda*	4.1
Market Capitalization (US$mm)	14,300	*PV/Ebitda*	5.1
Debt (US$mm)	3,200	*Undeveloped Reserves (%)*	23
Enterprise Value (EV) (US$mm)	17,500	*Natural Gas and Oil Ebitda (US$/boe)*	29.40
Present Value (PV) (US$mm)	21,500	*Present Value Proven Reserves(US$/boe)*	20.00
Net Present Value (US$/share)	68	*Present Value Proven Reserves(US$/mcfe)*	3.30
Debt/Present Value	0.15	*Earnings Next Twelve Months (US$/sh)*	6.77
McDep Ratio - EV/PV	0.81	*Price/Earnings Next Twelve Months*	8
Dividend Yield (%/year)	0.9	*Indicated Annual Dividend (US$/sh)*	0.49

Note: Estimated cash flow and earnings tied to one-year futures prices for oil, natural gas and refinery crack. Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

Summary and Recommendation

We continue a Buy rating on the common shares of **Petro-Canada (PCZ)** for the highest cash flow generation among Canada's integrated oil companies. The challenge is to redeploy cash from short-life properties to long-life assets. Oil produced offshore eastern Canada and internationally throws off cash at high rates while North American natural gas and oil sands offer long-life potential. Meanwhile the Canadian government no longer owns shares and the company appears to be managed capably. Our estimate of net present value of $68 a share appears justified by a constant real oil price of $35 a barrel while the recent average futures price for the next six years is $41.

Five Core Areas in Four Businesses

The company defines itself and reports financial results in five core areas, North American Natural Gas, Canada East Coast Oil, International, Downstream and Oil Sands. North American Natural Gas and Downstream match our functional distinctions while we look at the remaining three areas as two functional distinctions, oil and overseas natural gas (see table Functional Cash Flow and Present Value).

The recent acquisition of Prima Energy, the U.S. Rocky Mountain producer, lengthened the reserve life for the premium gas business (see column headed "Adjusted R/P"). Discoveries in the MacKenzie Delta would also lengthen life when transformed to reserves as a proposed Arctic pipeline project proceeds after imminent approval. Liquefied Natural Gas plans for Overseas Natural Gas would also involve more sustainable production.

Most of the company's value, to no surprise, is in oil production. Petro-Canada is reaping the reward from East Coast oil where it erected the "Eighth Wonder of the World", the Hibernia concrete platform built to withstand collision with an iceberg. International oil production includes volumes from Libya and Syria as a result of a timely acquisition of resources previously owned by the German company, Veba.

Oil Sands include Petro-Canada's twelve percent ownership of Syncrude, a valuable long-life asset that recovers oil from sands mined on the surface. In addition, the company has some current production and ambitious plans to recover oil from sands too deep to be mined, but susceptible to in-situ production by the SAGD, Steam-Assisted Gravity Drainage technique.

Downstream is linked to oil sands in a C$2.6 billion plan to upgrade the company's Edmonton refinery. By providing processing for its future heavy oil production Petro-Canada can earn the most value-added, as it does now with its share of Syncrude, and protect itself from potentially steep discounts for heavy oil.

Petro-Canada
Functional Cash Flow and Present Value

	NTM Ebitda (US$mm)	*Adjusted R/P*	*PV/ Ebitda*	*Present Value (US$mm)*	
North American Natural Gas	909	9.0	5.3	4,800	
Overseas Natural Gas	186	5.8	4.3	800	
Oil	2,489	7.3	5.1	12,700	
Downstream	643		5.0	3,200	
	4,227	7.6	5.1	21,500	
Debt (US$mm)					3,200
Net Present Value (US$mm)					18,300
Shares (mm)					269
Net Present Value (US$/sh)					68

More Gains Appear to Lie Ahead

Commodity price drives further gains in cash flow in our model (see table Next Twelve Months Operating and Financial Estimates). The high rate of cash flow implies a low multiple of Enterprise Value to Ebitda of about 4 times. The low multiple reflects in part a reserve life of 7.6 years on our adjusted basis that is shorter than for peer companies.

Most of management's decisions on reinvesting cash flow appear well-timed considering today's oil price. Investors' greatest concern may be the sustainability of the current level of oil price. Energy consumers and energy investors should, in our opinion, take recent oil price action as a sign of a long term change to higher price. Recent softening of oil price is welcome relief for the economy while we adjust to the price increases that have occurred and prepare for those that may occur in the future.

Petro-Canada
Next Twelve Months Operating and Financial Estimates
(Canadian Dollars)

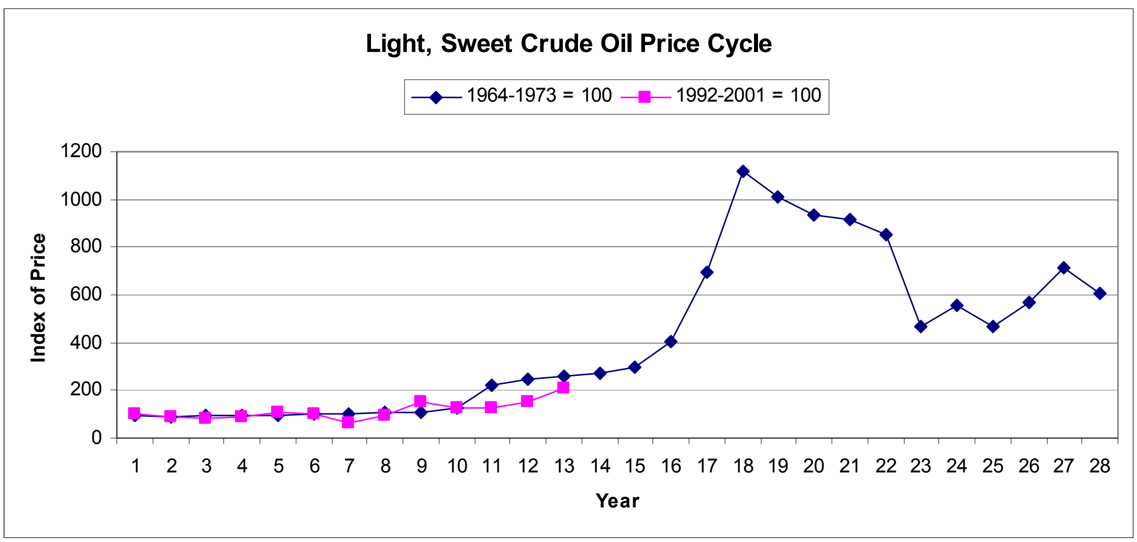
	Q1 *3/31/04*	*Q2* *6/30/03*	*Q3* *9/30/04*	*Q4E* *12/31/04*	***Year*** ***2004E***	*Q1E* *3/31/05*	*Q2E* *6/30/05*	*Q3E* *9/30/05*	***Next Twelve Months*** ***9/30/05***
Volume									
Natural Gas (mmcfd)									
U.S. (or North America)	508	531	521	521	**522**	508	508	508	**511**
Overseas	174	131	130	130	**142**	174	174	174	**163**
Total	682	662	651	651	**663**	682	682	682	**674**
Oil (mmb)	23.7	22.1	20.9	20.7	**87.3**	20.0	20.0	20.1	**80.8**
Oil (mbd)	260	243	227	225	**239**	222	220	218	**221**
Total gas & oil (mmb)	34.0	32.2	30.9	30.7	**127.7**	30.3	30.4	30.5	**121.8**
Total gas & oil (mbd)	374	353	336	333	**349**	336	334	332	**334**
Price									
Natural gas ($/mcf)									
Henry Hub (US$/mmbtu)	5.64	6.10	5.49	7.20	**6.11**	8.86	7.17	7.12	**7.59**
Currency (US$/C$)	0.76	0.74	0.77	0.82	**0.77**	0.82	0.82	0.82	**0.82**
Henry Hub (C$/mmbtu)	7.43	8.29	7.18	8.80	**7.94**	10.84	8.77	8.71	**9.28**
U.S. (or North America)	6.46	6.91	6.60	8.09	**7.02**	9.96	8.07	8.01	**8.52**
Overseas	5.26	5.19	5.00	5.79	**5.30**	5.53	5.39	5.24	**5.47**
Total	6.15	6.57	6.28	7.63	**6.65**	8.83	7.38	7.30	**7.79**
Oil ($/bbl)									
WTI Cushing (US$/bbl)	35.23	38.34	43.89	50.86	**42.08**	48.60	47.37	46.02	**48.21**
WTI Cushing (C$/bbl)	46.41	52.09	57.38	62.22	**54.52**	59.45	57.94	56.29	**58.97**
Worldwide	41.17	46.46	52.43	56.85	**48.91**	54.32	52.95	51.44	**53.91**
Total gas & oil ($/bbl)	37.43	42.33	45.72	51.00	**43.93**	51.01	47.20	46.08	**48.82**
NY Harbor 3-2-1 ($/bbl)	6.98	12.64	7.83	5.54	**8.25**	6.88	8.51	7.73	**7.16**
Revenue ($mm)									
Natural Gas									
U.S. (or North America)	299	334	316	388	**1,337**	456	373	374	**1,591**
Overseas	83	62	60	69	**274**	87	85	84	**325**
Total	382	396	376	457	**1,611**	542	458	458	**1,916**
Oil	974	1,027	1,095	1,175	**4,272**	1,088	1,061	1,032	**4,356**
Downstream	2,134	2,335	2,459	2,459	**9,387**	2,459	2,459	2,459	**9,836**
Other	(17)	(193)	(308)	(308)	**(826)**	(308)			**(616)**
Total	3,473	3,565	3,622	3,784	**14,444**	3,781	3,979	3,949	**15,492**
Expense									
Upstream	342	442	434	482	**1,700**	481	465	460	**1,888**
Downstream	1,933	2,124	2,328	2,289	**8,675**	2,269	2,246	2,246	**9,050**
Other	(17)	(193)	(308)		**(518)**				**-**
Total	2,258	2,374	2,454	2,771	**9,857**	2,750	2,711	2,706	**10,938**
Ebitda ($mm)									
Upstream	1,014	981	1,037	1,151	**4,183**	1,149	1,055	1,030	**4,384**
Downstream	201	211	131	170	**712**	190	213	213	**786**
Total	1,215	1,191	1,168	1,321	**4,894**	1,339	1,268	1,243	$\boxed{\mathbf{5,170}}$
Exploration	45	65	49	49	**208**	49	49	49	**196**
Deprec., Deplet., & Amort.									
Upstream	288	274	283	283	**1,128**	283	283	283	**1,132**
Downstream	67	69	69	69	**274**	69	69	69	**276**
Total	355	343	352	352	**1,402**	352	352	352	**1,408**
Ebit	815	783	767	920	**3,284**	938	867	842	**3,566**
Interest	37	38	33	33	**141**	33	33	33	**132**
Ebt	778	745	734	887	**3,143**	905	834	809	**3,434**
Income Tax	272	261	257	310	**1,100**	317	292	283	**1,202**
Net Income ($mm)									
Upstream	462	355	451						
Downstream	87	92	40						
Other	(44)	37	(14)						
Total	505	484	477	577	**2,043**	588	542	526	**2,232**
Shares (millions)	266	266	269	269	**268**	269	269	269	**269**
Per share ($)	1.90	1.82	1.77	2.14	**7.63**	2.18	2.01	1.95	**8.29**
Ebitda Margin (E&P)	80%	72%	73%	74%	**75%**	74%	74%	73%	**74%**
Tax Rate	35%	35%	35%	35%	**35%**	35%	35%	35%	**35%**

Oil Price Move Possibly Just Starting

To offset any inclination to underestimate further potential for oil and gas price, we compare the relatively stable price period from 1992 to 2001 to the period from 1964 to 1973. Each was a ten year period that immediately preceded a sharply lower stock market in 2002 and in 1974. After quiescence, oil price started moving up in each case. We may be in the early stages of a new historic move (see chart Light, Sweet Crude Oil Price Cycle).

Frankly, few investors would give much weight to the likelihood of continued oil price strength. Contrast that with the growing chorus for a weaker dollar. It may just be that oil price is not high, but the real value of the dollar is low. That, too, is a parallel to historical experience.

Let us imagine how the cycle might unfold. By the way we chose to draw the chart Year 13 corresponds to 1976 and 2004. Once the move got going in the previous cycle, the annual average oil price did not decline until Year 19 (1982). The annual peak of 1100, or 11 times the first ten year average, was too high to be sustained. It might be less disruptive economically if the peak ahead of us were lower and the decline shallower. The end point in Year 28 at 600 implies a tripling over the next 15 years. If higher oil price unfolded gradually it would give everyone time to adjust.



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